

## BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own Motion into the Operations and Practices of Sebastian Enterprises, Inc.; Fortel, Inc.; and Foresthill Telephone Company.

**FILED**  
**PUBLIC UTILITIES COMMISSION**  
**SEPTEMBER 7, 2006**  
**SAN FRANCISCO OFFICE**  
**I.06-09-007**

**ORDER INSTITUTING INVESTIGATION**  
**AND ORDER TO SHOW CAUSE**

**I. INTRODUCTION**

By this order, the Commission institutes an investigation to determine whether Sebastian Enterprises, Inc. ("SEI"), Fortel, Inc. ("Fortel"), or Foresthill Telephone Company ("Foresthill") violated any law in obtaining a loan and entering into a merger without the Commission's prior approval and directs them to show cause why a penalty should not be imposed if any violation is determined.

**II. BACKGROUND**

On March 8, 2005, SEI, corporate parent of Kerman Telephone Company and Kertel Communications, Inc., filed Application 05-03-008 jointly with Rose A. Hoeper to acquire from her control and ownership of Foresthill, possibly by means of an intermediate subsidiary, for \$14.5 million. On May 26, 2005, the Commission issued Decision 05-05-045, authorizing the proposed transfer. The Commission concluded, "This application should be approved and become effective immediately because it is not adverse to the public interest and the public may benefit from [SEI's] ability to maintain and expand Foresthill's services and operations in California." Mimeo at 7.

Following issuance of Decision 05-05-045, SEI formed a subsidiary, Fortel. Together they obtained a line of credit in the amount of \$10.5 million from Bank of America, which was used, along with \$4 million contributed by SEI, to complete acquisition of Foresthill. The loan was secured by the assets of SEI and Fortel, and had an initial period of 150 days, later extended for twelve months by its terms. On August 25, 2005, Foresthill merged with Fortel and assumed all of its liabilities, including the loan obtained from Bank of America. No party sought authorization from the Commission before obtaining the loan or entering into the merger.

On October 21, 2005, Foresthill filed Application 05-10-026 to issue two notes not to exceed \$24,901,250 in total. As proposed by Foresthill, one note would be issued to Rural Telephone Bank (“RTB”), and the other to Rural Utilities Service (“RUS”). The two notes would be used, among other things, to upgrade and expand Foresthill’s system and to replace the loan from Bank of America. Each note would be secured by a mortgage of Foresthill’s assets. On February 17, 2006, Foresthill filed a supplement to this application, proposing “to book ‘below the line’ in non-regulated accounts interest expense on the portion of the RUS loan used to retire the \$10.5 million of interim financing associated with the transfer of control.”

On June 29, 2006, the Commission issued Decision 06-06-068, authorizing Foresthill to enter into the proposed loans with RTB and RUS. The Commission concluded, “Because [these loans] represent a much lower cost of capital than either equity or other forms of debt, it is to Foresthill’s advantage to avail itself of such funds for its financing requirements.” Mimeo at 22. Moreover, “The merger of Fortel into Foresthill should be approved on a going-forward basis, to facilitate the proposed below-market-rate financing.” *Id.* At the same time, however, “Ratepayers should not pay for either principal or interest on the acquisition debt, as that is a benefit only to the owners of the company.” *Id.* In addition, with regard to possible statutory violations, “It is appropriate that the Commission open an investigation regarding compliance with § 851 in connection with the . . . interim financing and, if there is a violation, determine

whether and what penalties should be imposed.” Id. at 23. And finally, as part of that investigation, “The Commission should address whether Foresthill has accounted for any payments made on this interim debt compliant with the below-the-line requirements imposed by this Decision.” Id.

### **III. DISCUSSION**

The California Public Utilities Code closely regulates the activities of public utilities in this State in obtaining loans, entering into mergers, or otherwise in encumbering their assets. Under Section 818,

No public utility may issue . . . bonds, notes, or other evidences of indebtedness payable at periods of more than 12 months after the date thereof unless, in addition to the other requirements of law it shall first have secured from the Commission an order authorizing the issue, stating the amount thereof and the purposes to which the issue or the proceeds thereof are to be applied, and that, in the opinion of the Commission, the money, property, or labor to be procured or paid for by the issue is required for the purposes specified in the order, and that . . . such purposes are not, in whole or in part reasonably chargeable to operating expenses or income.

In turn, Section 854(a) provides,

No person or corporation . . . shall merge, acquire, or control either directly or indirectly any public utility organized and doing business in this state without first receiving authorization to do so from the Commission.

More comprehensively, under Section 851,

No public utility . . . shall sell, lease, assign, mortgage, or otherwise dispose of or encumber the whole or any part of its . . . plant, system, or other property necessary or useful in the performance of its duties to the public . . . nor by any means whatsoever, directly or indirectly, merge or consolidate its . . . plant, system, or other property . . . without first having secured from the Commission an order authorizing it to do so.

In sum, before obtaining a loan for a period longer than twelve months, entering into any merger, or otherwise encumbering its assets, a public utility operating in California must first receive authorization from the Commission.

**A. The Loan from Bank of America**

The Commission believes, based on the record developed during its review of Applications 05-03-008 and 05-10-026, that SEI and Fortel violated applicable law in obtaining the loan from Bank of America. By its terms, this loan provided for an initial period of 150 days, subject to an extension for an additional twelve months. See Decision 06-06-068, mimeo at 3-4. In apparent violation of Section 818, however, SEI and Fortel failed to obtain prior authorization from the Commission. Similarly, Section 851 required SEI and Fortel to obtain approval before entering into the loan since it was secured by their assets. Id. at 4.

**B. The Merger Between Fortel and Foresthill**

The Commission also believes that the merger of Fortel and Foresthill violated the Public Utilities Code. Despite the clear, unequivocal language of Section 854(a), no attempt was made by SEI, Fortel, or Foresthill to obtain the Commission's approval before entering into the merger. Relatedly, as a consequence of the merger, Foresthill assumed the liabilities of Fortel, including use of its assets as security for the loan from Bank of America. Id. Section 851 requires Foresthill to obtain authorization from the Commission, however, before encumbering its assets in any manner.

Therefore, **IT IS ORDERED** that:

1. An investigation is instituted on the Commission's own motion to determine whether SEI, Fortel, and Foresthill contravened any provision of the Public Utilities Code in obtaining the loan from Bank of America and entering into the merger between Fortel and Foresthill without first having obtained the Commission's authorization and whether Foresthill accounted for payment on the loan from Bank of America in the manner required by Decision 06-06-068.

2. SEI, Fortel, and Foresthill are directed to show cause why a penalty should not be imposed if any violation is determined in this investigation.

3. Pursuant to Rule 6(c) of the Commission's Rules of Practice and Procedure, this proceeding is categorized as adjudicatory.

4. A prehearing conference shall be convened before an Administrative Law Judge for the purpose of establishing a schedule in this matter, including the date, time, and location of an evidentiary hearing.

The Executive Director shall cause a copy of this order to be personally served on SEI at 811 South Madera Avenue, Kerman, California 93630; on Fortel, c/o of SEI, at 811 South Madera Avenue, Kerman, California 93630; and on Foresthill at 5915 Gold Street, Foresthill, California 95631.

This order is effective today.

Dated September 7, 2006, at San Francisco, California.

MICHAEL R. PEEVEY  
President  
GEOFFREY F. BROWN  
DIAN M. GRUENEICH  
RACHELLE B. CHONG  
Commissioners

Commissioner John A Bohn, being necessarily absent,  
did not participate.